

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY**

**FOR
TIMBER REAL ESTATE**

September 10, 2004

This Policy is effective immediately upon adoption and supersedes all previous timber real estate investment policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Timber Investment Real Estate Portfolio ("the Portfolio"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Portfolio. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of real estate.

II. STRATEGIC OBJECTIVE

Achieving the highest total rate of return possible, consistent with a prudent level of risk, the liabilities of the System, and the investment guidelines contained herein is the strategic objective of this Portfolio. The System's timber investments shall be considered a component of the specialized equity real estate portfolio. As such, the Portfolio shall achieve an appropriate risk adjusted return.

The Portfolio shall be managed to accomplish the following:

- A. Preserve investment capital;
- B. Generate attractive risk-adjusted rates of return for the System as a total return investor, including the following components:
 - 1. Provide, at a minimum, moderate to low cash flow from operations; and
 - 2. Provide appreciation potential as a result of biological growth and employing active management techniques including, but not limited to, silvicultural best practices.
- C. Provide a hedge against inflation; and
- D. Consider solely the interest of the System's participants and beneficiaries in

accordance with California State Law.

III. PERFORMANCE OBJECTIVES

Managing the Portfolio shall assist the System in achieving the following overall long-term objectives:

- A. Exceeding a minimum target real rate of return of 6.0% (after fees).
- B. Exceeding, on a before-fee basis, the National Council of Real Estate Investment Fiduciaries Timber Index ("NCREIF Timber Index") while maintaining an appropriate level of risk.

IV. INVESTMENT APPROACHES AND PARAMETERS

A. Environmental Considerations

Maximizing the economic benefits to the System is the primary objective of the timber investment program. The management of each investment shall incorporate sound environmental principles with full consideration of impacts on wildlife, water and air quality, recreation, and soil conservation. Respecting the desire to maintain environmental quality, the System shall strive to use the best and highest forest management standards commercially and economically feasible while meeting or exceeding the performance objective.

B. Investment Objectives and Criteria

1. Investment Quality

- a. Timberland tracts shall be comparable in quality to those held by other institutional investors or the forest products industry to enhance an exit strategy.
- b. Tracts shall be located within strong market areas defined as having multiple wood using facilities of various types (e.g., sawmills, pulp mills, and collection yards), preferably within 75 miles.
- c. Equity ownership of timber real estate shall be acquired, which includes underlying land, water, and mineral rights if available and economically feasible.

2. Diversification

The Portfolio shall be appropriately diversified to reduce risk. Furthermore, the Portfolio shall be managed to maintain a degree of

diversification with regard to geography and timber species, both age and product type.

a. Diversification by Geography

Allocation ranges have been established for each of the recommended geographic regions, as well as a domestic and international component. Market opportunities and conditions, rather than absolute and precise diversification targets, shall be the overriding factors in assembling the timberland portfolio.

<u>Region</u>	<u>Allocation Range</u>
<i>Domestic</i>	90-100%
South	40- 70%
Northwest	20- 50%
Northeast	0- 5%
<i>International</i>	0- 10%

The System may consider investing in international timber with full analysis of tax consequences among other factors. See Statement of Objectives and Policy for International Equity Real Estate (Section IV.A.1.). General U.S. environmental principles and land management best practices shall be considered prior to any international timber investment and in the property management and operation of an investment.

b. Diversification by Species, Age, and Product Type

The Portfolio shall be diversified so no one specie or product (pulpwood, sawtimber, or specialty hardwood) shall dominate the Portfolio.

The Portfolio shall be managed to maintain a degree of diversification in order to minimize market risk; that is, price dependence within a certain harvest period.

3. Investment Asset Size

Individual tract investments shall have a preferred size range of \$2-50 million in order to enhance liquidity of the Portfolio. A tract shall be one or more parcels of timberland with unity of title, use, and contiguity. Non-contiguous parcels of land may be considered a tract if there is unity in operation.

4. Investment Holding Period/Dispositions

The target holding period for timberland assets shall generally be for long-term investment (10 years or more). However, disposition of individual tracts may be triggered by an opportunity to capture a return in excess of the targeted return, or by a revised investment strategy resulting from changes in timber markets or changes in the System's financial objectives.

5. Leverage

Subject to qualifications stated in the Equity Real Estate Leverage Policy, the Timber Real Estate Investment Portfolio shall be permitted to leverage the portfolio up to a maximum of 40%, subject to approval by the SIO Real Estate or the Chief Investment Officer.

6. Property Management

- a. The investment manager shall be responsible for developing operating management plans, strategic plans and budgets, and on-site supervision of each timberland holding. Tracts must be physically inspected at least once a year. Emphasis shall be placed on active management to capitalize on opportunities that add value.
- b. On-site property management shall be conducted, under the supervision of the investment manager, by firms with an established presence in the local timberland markets and demonstrated expertise in optimizing timber property performance.
- c. Each holding shall be managed to maximize its timber producing capabilities.
 - (1) Open areas shall be planted as soon as possible.
 - (2) Roads and boundary lines shall be inspected and maintained regularly.
 - (3) Hunting rights and other sources of lease income shall be obtained where possible.
- d. Management shall comply with all appropriate federal, state, and local regulations.
- e. Where prudent and economically practical, recreational use of

properties shall be permitted, with consideration for minimizing legal liability risks.

- f. The generation of cash flow shall be secondary to producing long-term total returns.

7. Prohibited Investments

The purchase of land for the primary purpose of commercial land development and speculation shall be prohibited.

V. GENERAL

Terms in this policy are defined in a master glossary of terms.

VI. VALUATION

All calculations and computations shall be on a fair market value basis unless otherwise noted. Market value, as defined by the Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation, shall be incorporated when reporting fair market value for accounting purposes. The standards of the timber industry in appraising timberland shall be followed where there are differences between USPAP and timber industry practices.

VII. ASSET ALLOCATION

The following is the current asset allocation range for the Timber Portfolio, as a percent of the total allocated Real Estate Portfolio:

	<u>Range</u>
Timber Portfolio:	10-20%

As a percent of the total allocated Specialized Portfolio, timber shall range from 20-45%.

From time to time, the actual allocation may fall out of the ranges prescribed by the Policy. In these instances, adjustments to correct the actual in order for it to comply with the Policy allocation ranges shall be implemented on an opportunistic basis over a reasonable time frame (normally within a three-year period), and with ample consideration given to preserving the investment returns of the System.

VIII. GLOSSARY OF TERMS

The Real Estate Glossary of Terms is referenced in the System's Master Glossary of Terms.

Appendix I

Distribution of States for Timber Geographic Allocation

Northwest Region	South Region	Northeast Region	Midwest Region
<i>Alaska</i> <i>Arizona</i> <i>California</i> <i>Colorado</i> <i>Hawaii</i> <i>Idaho</i> <i>Montana</i> <i>Nevada</i> <i>New Mexico</i> <i>Oregon</i> <i>Utah</i> <i>Washington</i> <i>Wyoming</i>	<i>Alabama</i> <i>Arkansas</i> <i>Delaware</i> <i>Florida</i> <i>Georgia</i> <i>Kentucky</i> <i>Louisiana</i> <i>Mississippi</i> <i>Tennessee</i> <i>Missouri</i> <i>North Carolina</i> <i>Oklahoma</i> <i>South Carolina</i> <i>Texas</i> <i>Virginia</i> <i>West Virginia</i>	<i>Connecticut</i> <i>Maine</i> <i>Maryland</i> <i>Massachusetts</i> <i>New Hampshire</i> <i>New Jersey</i> <i>New York</i> <i>Pennsylvania</i> <i>Rhode Island</i> <i>Vermont</i>	<i>Illinois</i> <i>Indiana</i> <i>Iowa</i> <i>Kansas</i> <i>Michigan</i> <i>Minnesota</i> <i>Nebraska</i> <i>North Dakota</i> <i>Ohio</i> <i>South Dakota</i> <i>Wisconsin</i>